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DAVID E. JANSSEN
Chief Administrative Officer

August 12, 2003

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

RESTATEMENT OF THE DEFERRED COMPENSATION AND THRIFT PLAN
(3 VOTES)

IT IS RECOMMENDED THAT YOUR BOARD:

1. Approve the attached ordinance restating the County Deferred Compensation and Thrift Plan.

PURPOSE/JUSTIFICATION OF RECOMMENDED ACTION

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Job Creation and Worker Assistance Act of 2002 (JCWAA) and recently released Internal Revenue Service regulations relating to Internal Revenue Code (IRC) Section 457 have made several changes to the law governing eligible deferred compensation plans of local governments, including increasing the amounts employees can save on a pre-tax basis by contributing to the County Deferred Compensation and Thrift Plan (also known as Horizons). EGTRRA, JCWAA and the regulations also ease restrictions on distributions from Horizons, allow rollovers into Horizons from the eligible rollover plans of other employers and permit plan loans. To realize the benefits of many of these changes which can be achieved at no cost to the County, the Horizons plan must be restated to include provisions which allow them.

The attached ordinance makes two other significant changes. The requirements in the new regulations that relate to the contributions that vest over time and the earnings on those contributions are unfeasible to implement administratively. Accordingly, we recommend that matching contributions which are currently subject to a five-year vesting schedule become fully vested. In addition, administrative fees charged to participants have been frozen for many years pursuant to an agreement with the Coalition of County Unions and Local 660 SEIU. These fees are no longer sufficient to sustain plan operations over the long haul. The unions have agreed to a procedure which is codified in the proposed restatement by which the Plan Administrative Committee (PAC) of Horizons after careful study may make adjustments to the fees within a narrow range.

We have met and conferred concerning the foregoing changes with Local 660 SEIU and the Coalition of County Unions and their legal counsel, and they agree with the changes.

Implementation of Strategic Plan Goals

Adoption of the accompanying ordinance will contribute to the achievement of Strategic Plan Goal 2, workforce excellence, by improving employee morale through enhanced ability to save for retirement.

FISCAL IMPACT/FINANCING

Vesting

The concept of a matching contribution that is subject to a vesting schedule was introduced to Horizons as an employee retention tool at the plan's inception in 1985. Participants who leave County service before they earn five years of vesting service in the plan forfeit a portion of their matching contribution account. By law, these forfeited amounts must stay in the plan and, under the terms of Horizons, can be used to reduce the County's matching contribution obligation. Since 1985, the amount of forfeitures that have been available to reduce the County's matching contributions has been relatively small in relation to total County matching contributions. In recent years, forfeited matching contributions that have been used to reduce the County's contribution have averaged approximately $225,000 per year.

From plan inception to date, the County has limited the sum of annual personal and matching contributions (whether or not vested) to the Horizons Plan to the IRC section 457 annual dollar contribution limit (Section 457 limit). At plan inception, this limit was $7,500 and has increased to $12,000 in the current year. The new IRS regulations make clear that the Section 457 limit must be calculated as the sum of the employee's personal contributions, the County's matching contributions that vest in the applicable year, and any past earnings on those vested amounts. Under the new regulations, any excess over the Section 457 limit must be returned to the employee as taxable income.

There is no feasible accounting and recordkeeping method to implement this change in calculating and monitoring the Section 457 limit. Moreover, if it were feasible to implement, it would be very difficult to communicate the consequences to employees. For example, under this method of calculating the annual limit, none of the County's matching contributions that were made on behalf of an employee would count against the Section 457 limit during the employee's first year of participation in the plan because the employee does not become 10 percent vested until his first anniversary of participation in the plan. In that same employee’s sixth year of participation in Horizons, approximately 60 percent of all of the matching contributions plus interest earned on those contributions during the five-year vesting period would have to be counted against the Section 457 limit. That employee’s ability to make personal contributions and receive matching contributions in the sixth year would be greatly reduced and, in some cases, an employee might not be able to contribute at all.

Plan Administrative Fees

For the last 13 years, plan administrative fees charged to Horizons participants have been frozen at $2.20 per month, per participant by agreement with the Coalition of County Unions and Local 660 SEIU. The administrative fee is used to pay necessary plan expenses such as the cost of County staff who provide services to the plan, plan auditors, and financial, legal and communications advisors. Over the years, the plan built up substantial reserves, which, in recent years, have been drawn down by the PAC to pay necessary plan expenses.

This year PAC has been able, through belt tightening, to limit the projected deficit between plan expenses and the administrative fees paid by participants to $300,000. While there are still sufficient reserves to cover this amount, continued deficits eventually will result in the plan's inability to pay its necessary and reasonable expenses. The Coalition of County Unions and Local 660 SEIU have agreed to amend Horizons to permit the PAC to adjust the administrative fees charged to participants within a narrow range. This agreement supports your Board’s long standing policy of requiring that operation of County deferred compensation plans be fully self supporting at no cost to the County.

FACTS AND PROVISIONS/LEGAL REQUIREMENTS

To insure that the Horizons Plan assets continue to be protected from current taxation, after adoption of the accompanying ordinance, the restated Horizons Plan will be submitted to the IRS for a private ruling that the plan is an eligible deferred compensation plan of a local government under IRC section 457(a). In addition to the new provisions described above, several of the plan's existing provisions have been restated to facilitate IRS approval.

The accompanying ordinance has been approved as to form by the County Counsel.

IMPACT ON CURRENT SERVICES

County employees will receive improved plan services.

Respectfully submitted,

DAVID E. JANSSEN
Chief Administrative Officer

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Attachments (1)

c: County Counsel
Executive Officer, Board of Supervisors
Each Member of the Horizons Plan Administrative Committee
Coalition of County Unions
Local 660